ANNUAL REPORT

YEAR ENDED DECEMBER 31, 1946

NABISCO
TRADE MARK

NATIONAL BISCUIT COMPANY

NATIONAL BISCUIT COMPANY

449 West Fourteenth Street

New York, N. Y.

To the Stockholders:

The year 1946 presented more obstacles to the operation of our business than any of the war years.

By the end of 1945 a great shortage of food existed in Europe and the Far East. Our government wished to relieve these famine conditions as far as possible. Wheat and flour were commodities most easily obtained in large quantities and most easily exported, and they became the chief media used for relief.

By Directive dated February 6, 1946 the President asked for the domestic conservation of wheat so that it could be used for the relief of starving people abroad.

Pursuant to the President's Directive, War Food Order 144 was issued on February 15, 1946 and it continued to affect us in various ways until December 1, 1946.

For the period from March 1, 1946 to September 1, 1946 our mills and those of our suppliers were required to produce only flour consisting of at least 80% by weight of the cleaned wheat from which it was produced. Ordinary flour was and is of 72% extraction. The new flour contained more bran, its production required certain technical changes in the mills, and its use did not improve the quality of our products.

Between April 1, 1946 and June 30, 1946 our mills and those of our suppliers were required to limit their production of flour to 75% of the amount distributed in the corresponding months of 1945. From July 1, 1946 to December 1, 1946 this limitation was 85%. These limitations applied also to other forms of wheat processing and likewise curtailed the production of Shredded Wheat, Shreddies, Wheatsworth Cereal and Nabisco 100% Bran.

The effect of these wheat and flour orders was to reduce the supply and at various times during the periods mentioned mills and bakeries were closed down for lack of wheat or flour.

The uncertainty which persisted throughout the year regarding the fate of O.P.A. likewise had a tendency to reduce the available supplies of raw materials, particularly shortenings, our principal raw material next to flour, and consequently curtailed production.

Early in the Spring the shortening supply began to dwindle due to decreasing arrivals of livestock at the principal markets brought about by expectation of higher ceiling prices later. On June 30, when the O.P.A. expired temporarily, the average wholesale price of available lard, for instance, was about 16¢ per pound. During the period in which controls were temporarily off, it reached 37¢ per pound. When controls were reimposed, the average ceiling price was fixed at approximately 20¢ per pound and the supply promptly dried up. Between September 1 and October 16, when controls were removed altogether, many bakeries were closed down for lack of shortening. In October, after decontrol, lard reached 55¢ per pound and is still in the process of settling down to a reasonable price.

Sugar has remained in short supply throughout the period and continues so. We are presently operating on a quota of 60% of our 1941 consumption and no relief is promised, at least for the first quarter of 1947. What may happen thereafter remains uncertain.

From October 29, 1945 until March 11, 1946 all industries employing machinists in San Francisco were closed down by a machinists' strike. This included our San Francisco bakery and the loss of its production resulted in serious curtailment of deliveries to the trade in a large area of the Pacific Coast during all of that period.

Between September 3, 1946 and November 4, 1946 virtually all deliveries in New York City and vicinity were prevented by the trucking strike. This suspended all business with customers in Metropolitan New York and parts of Westchester County, Long Island, and New Jersey.

Following is a report of the financial condition of the Company and subsidi-

aries as of December 31, 1946, a statement of earnings, and more detailed comments on its activities during the past year — its forty-ninth year of operation.

EARNINGS

Earnings in 1946, before loss on disposal of fixed assets and taxes on income, were $28,887,601 compared with $29,078,859 in 1945. Such earnings were lower in relation to sales in 1946 because of increased costs of raw materials and labor, plus the fact that it was not until August that O.P.A. granted price relief in our industry.

Net earnings for the year 1946, exclusive of the processing tax settlement explained further on in this report, were $17,162,294 compared with $10,508,448 in 1945. After provision for dividends on the preferred stock, this is equal to $2.45 per share on the common stock. Net earnings in 1945 were $1.39 per share of common stock. Improved net earnings are due principally to the elimination of Excess Profits taxes in 1946.

Including the non-recurring item of $2,492,684.62 arising from settlement of the processing tax claim and applying to operations prior to 1936, net income for 1946 was $19,654,979 or $2.85 per share of common stock.

In July while price controls were temporarily off and prices of raw materials soared, we considered it unwise to make any price increases on our products, realizing that in August controls would be reimposed and our prices would have to be rolled back with resultant confusion in the trade. However we did make application to O.P.A. for a price increase and in August, when controls were restored, our industry was granted a general price increase, the first since price regulations were imposed in 1942, which partly compensated for increased costs. In October, when controls were finally removed, we made a further price adjustment, sufficient to cover the increased costs existing at that time.

SALES

Net sales, after deduction of trade and cash discounts, returns and allowances, were $220,195,488 compared with $204,995,178 in 1945. This represents another new high in sales to civilian customers both in dollars and tonnage. As in the previous year, raw material

shortages were such that we were unable to supply the demand for our products. We continued to apportion available merchandise to all customers based on their historical record of purchases.

As stated more fully in the introductory paragraphs of this report, Government limitations on the use of basic raw materials hampered production almost continuously throughout the year.

PROCESSING TAX REFUND CLAIM AND SETTLEMENT

In May 1933 Congress enacted the Agricultural Adjustment Act. Among other things, it provided for a tax on the first domestic processing of basic agricultural commodities, the proceeds of which would provide benefit payments to farmers, bringing their purchasing power up to that of a designated base period.

Under the provisions of the act, a tax at the rate of 30¢ per bushel was levied on the first domestic processing of wheat. Between July 1933 and June 1935 the Company and its subsidiaries paid $4,083,127.49 in such taxes.

In July 1935, while suits were pending to test the constitutionality of the Agricultural Adjustment Act, the government took action to obtain legislation which would limit the taxpayer's right to recover processing taxes illegally collected, should the courts find the A.A.A. unconstitutional. To preserve its rights the Company commenced suits in equity to enjoin the collection of further taxes. Injunctions were granted and taxes covering the period from June 1935 to January 6, 1936 in the amount of $1,492,684.73 were deposited in escrow pending decision on the constitutionality of the Act.

On January 6, 1936, in a case brought by the Receivers of the Hoosac Mills Corporation, the court found the Agricultural Adjustment Act unconstitutional. Later in the year 1936 the Revenue Act of 1936 was enacted, dealing among other things, with claims for refund of processing taxes collected under the A.A.A. and providing for a so-called windfall tax of 80% on amounts of taxes held in escrow or otherwise unpaid. The Company filed claims for refund of processing taxes paid, in the amount of $4,083,127.49, and the Government asserted a claim for windfall

tax on the $1,492,684.73 turned back to the Company from the escrow agents when the A.A.A. was declared unconstitutional. This amount was carried in the Reserve for Federal and Foreign Income and Excess Profits Taxes pending final settlement with the Government.

For a period of ten years attempts to reach a settlement with the Government were unsuccessful. The matter was complicated by the provisions of the Revenue Act of 1936 requiring a taxpayer, in support of his claim for refund of processing taxes, to prove that he had not "passed on" the tax to the buyers of his products. This question of the incidence of taxation, being one on which experts seldom agree, made settlement of these cases very difficult.

Finally suit was instituted by the Company in the Tax Court of the United States and was to have been heard in November 1946. Just before trial, settlement was effected resulting in a net credit to the Company of $2,492,684.62 which is shown as non-recurring income in this report.

TAXES

Federal and foreign income tax provisions in 1946 were $11,686,499. Total taxes in 1946 were $15,739,137, equivalent to $2.50 per share of common stock, or 7 cents on each dollar of sales.

Our domestic income tax returns have been audited by the Treasury Department up to and including the year 1942. It is not expected that final determination of tax liability, when years subsequent to 1942 are audited, will result in any substantial changes.

No final action has been taken by the Treasury Department upon our claim for refund of Excess Profits Taxes. As was stated in last year's Annual Report this claim has been filed under the provisions of the Revenue Act providing for relief where for one reason or another the basis on which the tax is computed is improper or inequitable. It is impossible at this time to predict what the final determination may be.

SUBSIDIARIES

The operating subsidiaries of the Company, three in Canada and one in England, experienced no serious diffi-

culties during the year. They all showed satisfactory results and accounted for 6% of the Company's net operating earnings in 1946. Rising costs and price control in those countries resulted in a narrowing of profit margins.

For comparative purposes we continue to include the earnings from our English subsidiary at $4.85 to the pound sterling, but reduce them to the current rates through the Foreign Exchange Adjustment Account, so that the net results are finally included in the Consolidated Income Statement in equivalent United States dollars. Since the Canadian dollar is now on a par with our own, no adjustments of the Canadian earnings for 1946 were necessary.

We have continued our practice of including current assets and current liabilities of foreign subsidiaries in the consolidated balance sheet at the current rate of exchange, charging any necessary adjustment against earnings. Here again, no adjustment was necessary this year for the Canadian companies because of the parity of the Canadian dollar. The reserve for the Canadian subsidiaries at the end of 1945, amounting to $292,728.95, has been transferred to Insurance and Contingent Reserve to protect us against possible future change in the value of the Canadian dollar.

Foreign investments of the Company located in Canada and England, and included in the Consolidated Balance Sheet at the close of the year, amounted to $6,893,000. The fiscal authorities in Canada and England permit the Company to withdraw cash funds from those countries in amounts substantially equivalent to current earnings of the subsidiaries.

GOVERNMENT CONTRACTS

We have received settlement from the Government on all contracts terminated at the close of the war. This was accomplished without loss to the Company.

Profits arising from Government contracts for the year 1945 have been examined by the Price Adjustment Board of the War Department and we have agreed to an adjustment of $75,864.00. Credit for taxes paid reduced the refund to $11,000.28. Provision for this refund had been made in the year 1945.

Thus all war contracts have been terminated and all renegotiations completed.

PURCHASE COMMITMENTS

The nature of our business is such that inventories, both of raw material and finished products, can little exceed current needs, and the Company does not enter into future commitments at any time in such amount as to affect its financial position materially.

INVENTORY RESERVE

The Raw Materials, Supplies and Finished Product Account shown in the balance sheet is higher than at any time in the past. This is brought about by higher material costs not greater quantity. Because of high prices and unsettled conditions we felt that our Inventory Reserve of $1,019,381.51 should be increased. We have accordingly increased it to $5,000,000.00. Heretofore the Inventory Reserve has been deducted from the asset account of Raw Materials, Supplies and Finished Product and so noted on the balance sheet, but in this report it is shown as a separate item among the liabilities. The balance sheet for the year 1945, presented herein for comparative purposes, has been conformed accordingly.

ADDITIONS AND CHANGES IN PLANTS AND EQUIPMENT

On February 1, 1946 we acquired the business and property of the J. H. McGaulley Company at Plattsburg, New York, engaged in the manufacture of bread and soft cake. Acquisition of this business permitted the distribution of bread and soft cake products in northeastern New York, rounding out and complementing the business now done by our Syracuse, New York, Glens Falls, New York, and Burlington, Vermont, bakeries.

Early in the year we set about replacing old steel and wooden storage tanks at the Toledo flour mill with new concrete tanks. The tanks replaced constituted about a quarter of the total wheat storage capacity and their replacement will increase the capacity from 4,000,000 to 6,000,000 bushels of wheat. While some delay has been experienced in the delivery of certain machinery, it is believed that the new tanks will be ready for use at the time of the next wheat harvest.

In last year's Annual Report we mentioned plans for a pretzel bakery in our New York plant, an automatic soft cake

bakery in our East Liberty, Pennsylvania plant, an additional automatic Shredded Wheat oven in our Oakland, California bakery, and an additional Triscuit unit in our Niagara Falls, New York bakery. All this equipment has been on order for some time and we expect delivery in the near future.

Plans were completed this year for an addition to our Erie Avenue plant at Niagara Falls, New York, to permit the installation of automatic Shredded Wheat ovens. This equipment likewise has been on order for some time and the change will be completed as soon as possible.

The new bakery in Toronto, Canada mentioned in last year's Report is now under construction and the bakery in Houston, Texas will proceed as soon as we receive the necessary Civilian Production Administration approval. We are at this writing negotiating for a site for the bakery in the Pacific Northwest.

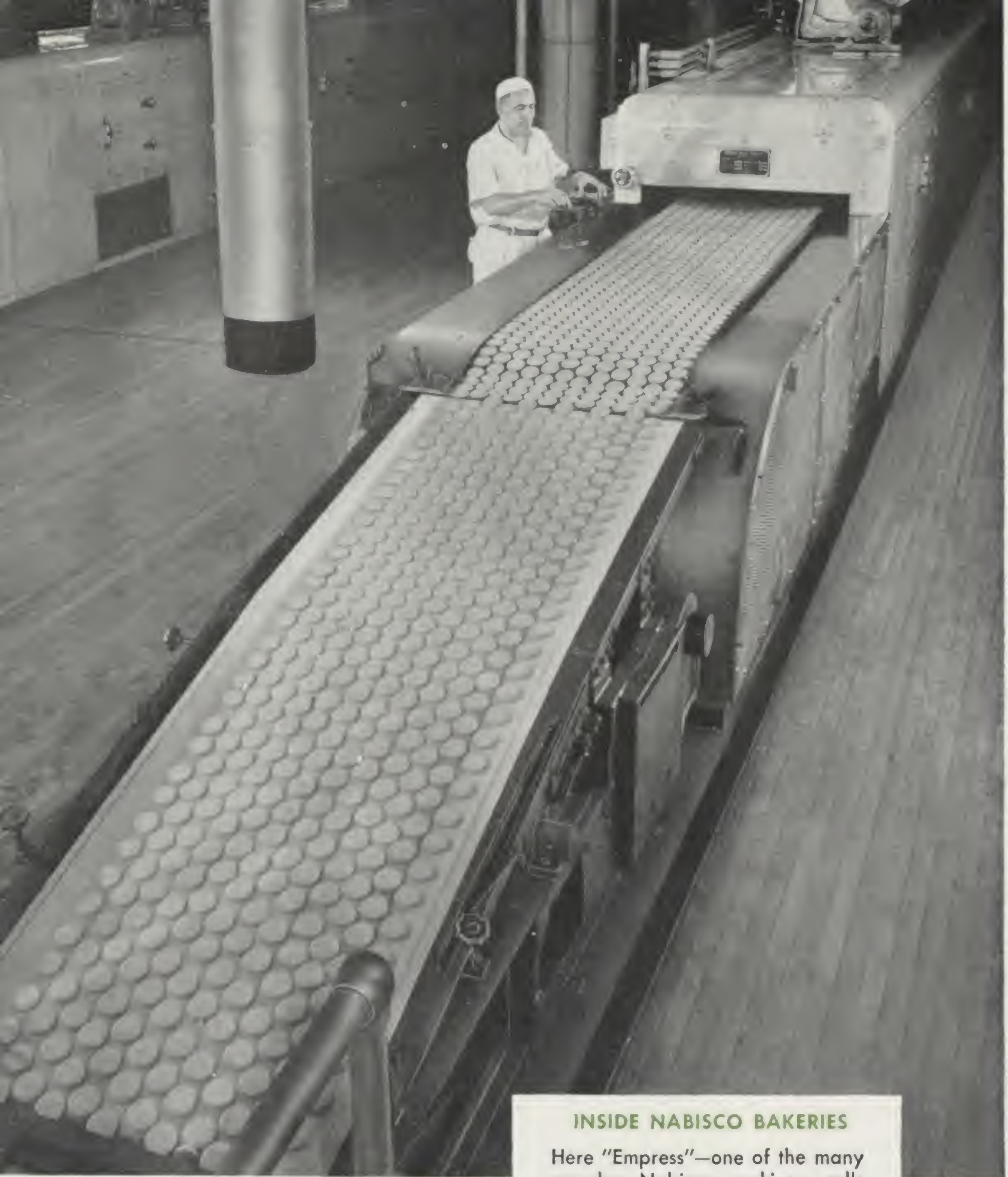
A new bread bakery has been planned for Elmira, New York, and it is expected that construction will start in 1947.

We have approved during the year appropriations calling for the expenditure over a period of several years of approximately $28,000,000.00 for new plants and equipment and for the modernization and improvement of existing facilities. In the immediate future we shall make further appropriations. During the war years our plants ran much overtime—around the clock in some cases—with few, if any, machinery replacements. It is not surprising that we are faced with large expenditures before we shall have made up for the years during which improvements and replacements were virtually at a standstill. There are still many restrictions and delays but it is hoped that these will clear up soon.

We have made substantial progress during the year in the procurement of delivery equipment and by the end of 1947 our fleet should be back to normal in efficiency and appearance.

PENSION PLAN

As was stated in our report to the stockholders following the last annual meeting, the pension plan proposed by the management and submitted to the stockholders was adopted at that meeting, April 10, 1946, and became effective May 1, 1946.



INSIDE NABISCO BAKERIES

Here "Empress"—one of the many popular Nabisco cookies — rolls tempting and fragrant from the modern, streamlined band oven.

Mixing the Dough. Giant mixers blend the specially prepared flour with water, shortening, and other ingredients.

Preparing the Dough. Here the dough is rolled into thin sheets, then cut or stamped into crackers ready for baking.

Baking the Crackers. This tra
built by National Biscuit Company, i

Preparing the Carton. Autom
ton; cut, shape, and insert the wax

ng band oven, designed and
e last word in cracker baking.

machines form the Ritz car-
aper lining in one operation.

Filling the Carton. Ritz Crackers pour from automatic filling machines, while girls check the weight of filled packages.

Chocolate Mallomars move up to receive their coating of rich, luscious chocolate which fills the air with delicious aroma.

Immaculate Workers pack the chocolate-covered cookies in cellophane bags to reach the stores fresh, tender, and at the peak of their goodness.

Prior to the adoption of the formal plan, the Company had for many years operated under an informal pension plan. In the year 1946 $425,946 was paid to former employees pensioned under the old plan. Between May 1, 1946 and December 31, 1946 227 employees were pensioned under the new plan and payments to such employees for the period amounted to $82,592.

Total pension payments for the year 1946 under both old and new plans amounted to $508,538.

RESEARCH

Steps were taken during the year to expand the Company's research activities both as to personnel and facilities.

Plans have been completed and equipment ordered for a new laboratory to occupy a floor, yet to be constructed, on top of the newest of the group of bakery buildings at Tenth Avenue and Fifteenth Street, New York City. This project has been delayed pending approval by the Civilian Production Administration. This approval has recently been granted. It will proceed just as rapidly as circumstances will permit. When completed it will treble our present facilities.

We have added materially to the personnel and equipment in the experimental machine shop and that whole department has been reorganized in a manner which will permit it to work more intensively on the job of improving manufacturing processes.

During the year we established a Marketing Research Department under an experienced director. Marketing research, properly conducted, can take much of the guesswork out of the determination of consumer attitudes towards products, prices and policies.

These are long term projects but we feel they will show tangible results in the years to come.

ORGANIZATION CHANGES

On January 21, 1946 William White, president of The Delaware, Lackawanna and Western Railroad Company, became a member of the Board of Directors succeeding C. P. Montgomery who resigned as of December 31, 1945. Mr. White's interim election by the directors was followed by his election at the stockholders' meeting on April 10, 1946.

On November 25, 1946 Russell M. Shultz was elected a vice president of the Company. He assumed the direction of Operations, including Production, Engineering and Research. Mr. Shultz has had twenty years experience with the Company as a research chemist, bakery manager and Director of Research.

On December 23, 1946 Thomas F. Burke was elected a vice president of the Company. He continues in charge of the Company's Bread Department of which he had been manager for about two years. Previous to his appointment to the Bread Department Mr. Burke had been a district sales manager in the biscuit and cracker end of the business. He has been in the employ of the Company thirty-six years.

EMPLOYEES

With employees continuing to return from the Armed Forces, both the calibre of the personnel and the efficiency of operations have improved. Higher wages in 1946 have resulted in many instances in improved efficiency and the present spirit of cooperation on the part of employees leads us to look for further improvement in 1947.

During the year 1946 there were no strikes originating with our employees. We were affected by the trucking strike in New York City and the machinists' strike in the San Francisco area but both of these originated outside of our business.

Within the year we completed the organization of a Personnel Relations Department to deal with that increasingly important phase of the business. We have staffed it with experienced people who we feel will make major contributions to successful operation in the immediate future.

THE FUTURE

We enter 1947 relatively free of Government limitations and controls for the first time in several years. More plentiful supply of principal raw materials, with the exception of sugar, gives promise of expanding production. As of this writing, consumer demand for our products continues at unprecedented levels. Indications are that our business in the foreseeable future will be good.

George H. Coppers, *President.*

SUMMARY OF OPERATIONS

YEAR—1946

	Amount
Income from the sale of our products	$220,195,488
Other income, including non-recurring item	2,817,458
Total Income	$223,012,946
Expenditures to produce this income were:	
Raw materials, supplies and services	$114,780,843
Salaries and wages paid to employees	68,715,671
Direct taxes	15,739,137
Estimated wear and tear on plant and equipment	3,583,075
Loss on sale of fixed assets not needed to produce income	38,808
Officers' salaries for management of the business	500,433
Leaving profits which were:	
Distributed as dividends to stockholders	$9,283,653
Retained in the business for future needs	10,371,326

	Per Dollar of Income
Raw materials, supplies and services	51.5¢
Salaries and wages paid to employees	30.8
Direct taxes	7.1
Estimated wear and tear on plant and equipment	1.6
Loss on sale of fixed assets not needed to produce income	—
Officers' salaries for management of the business	0.2
Distributed as dividends to stockholders	4.2
Retained in the business for future needs	4.6

CONSOLIDATED

ASSETS

	December 31, 1946	December 31, 1945
Cash	$12,784,688.74	$15,424,266.81
U. S. Bonds (Quoted Market 12-31-46 $29,023,084.57)	28,973,000.00	30,774,443.26
Other Bonds (Quoted Market 12-31-46 $1,281,196.91) Note: $691,500.00 Principal Amount U. S. and Other Bonds deposited for special reasons	1,269,562.53	1,183,291.25
Accounts Receivable	6,711,610.87	4,722,992.31
Raw Materials, Supplies and Finished Product (At Cost or Market, whichever is lower)	34,549,277.22	27,052,362.89
Total Current Assets	84,288,139.36	79,157,356.52
Notes and Mortgages Receivable	140,180.33	154,644.86
Post-War Refund of Excess Profits Taxes (Canada)	397,341.41	395,777.19
Plants, Real Estate, Machinery and Equipment (At Cost, Less Allowances for Depreciation of $44,054,240.07 at December 31, 1946)	52,246,331.42	52,563,332.98
Prepaid Expenses and Deferred Charges	1,553,429.86	1,206,876.25
Total	$138,625,422.38	$133,477,987.80

NOTE: Along with industry generally, we have had several so called "portal to portal" pay suits approximating $50,000,000 instituted against us. Of course the amount is fantastic, is not the result of any computation, and has no relation to facts. At the time of this writing the whole question is thoroughly confused and will continue to be so until Congress or the courts take steps to clarify it. In the meantime, all necessary action will be taken to protect the Company's position.

BALANCE SHEET

LIABILITIES

	December 31, 1946	December 31, 1945
Accounts Payable . . . . (Purchase Invoices, Pay Rolls and other Accruals not due for payment)	$6,291,853.57	$5,524,976.44
Common Dividend, Payable January 15, 1947	1,886,834.40	1,886,834.40
Reserve for Federal and Foreign Taxes on Income . .	13,521,264.91	19,806,810.31
Total Current Liabilities	21,699,952.88	27,218,621.15
Insurance and Contingent Reserve	3,662,306.19	3,367,529.24
Inventory Reserve	5,000,000.00	1,019,381.51
Capital Stock, Preferred . . . . (Par Value $100.00—7% Cumulative) Shares authorized 250,000, issued 248,045	24,804,500.00	24,804,500.00
Capital Stock, Common . . . . (Par Value $10.00) Shares authorized 12,000,000, issued 6,289,448	62,894,480.00	62,894,480.00
Earned Surplus	20,564,183.31	14,173,475.90
Total	$138,625,422.38	$133,477,987.80

CONSOLIDATED INCOME AND EARNED SURPLUS
YEAR—1946

Net Sales		$220,195,488.15
Cost of Sales	$145,019,418.26	
Selling, General and Administrative Expenses	38,858,036.80	
Depreciation	3,583,075.25	
Foreign Exchange Adjustments	119,491.93	
Taxes (other than Federal and Foreign Taxes on Income)	4,052,638.36	191,632,660.60
Income from Operations		28,562,827.55
Interest, Rents and Miscellaneous Income		324,773.29
Total		28,887,600.84
Loss on disposal of Fixed Assets	38,808.00	
Provision for Federal and Foreign Taxes on Income	11,686,498.96	11,725,306.96
Earnings for the year before non-recurring income		17,162,293.88
Income from settlement of Processing Tax claim		2,492,684.62
Total		19,654,978.50
Transferred to Inventory Reserve		3,980,618.49
Balance of Net Earnings transferred to Surplus		15,674,360.01
Earned Surplus December 31, 1945		14,173,475.90
		29,847,835.91
Preferred Dividends Paid	1,736,315.00	
Common Dividends Paid	5,660,503.20	
Common Dividend, Payable January 15, 1947	1,886,834.40	9,283,652.60
Earned Surplus December 31, 1946		$20,564,183.31

REPORT OF AUDITORS

To the Stockholders of
National Biscuit Company,
New York, N. Y.

We have examined the consolidated balance sheet of National Biscuit Company and its subsidiary companies as of December 31, 1946, and the consolidated statement of income and earned surplus for the fiscal year then ended, have reviewed the systems of internal control and the accounting procedures of the companies and, without making a detailed audit of the transactions, have examined or tested accounting records of the companies and other supporting evidence, by methods and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary.

In our opinion, the accompanying balance sheet and related statement of income and earned surplus present fairly the consolidated position of National Biscuit Company and its subsidiary companies at December 31, 1946, and the consolidated results of their operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Lybrand, Ross Bros & Montgomery

New York, N. Y.
February 5, 1947.

BOARD OF DIRECTORS

ROY E. TOMLINSON—*Chairman*

CHARLES C. AUCHINCLOSS
HENRY J. COCHRAN
GEORGE H. COPPERS
FRANKLIN D'OLIER
ROBERT A. FAIRBAIRN
DUDLEY W. FIGGIS
ROY C. GASSER
EDWARD F. LOW
FRANK K. MONTGOMERY
EDWARD S. MOORE
PAUL MOORE
ALEXANDER C. NAGLE
LIVINGSTON PLATT
WILLIAM WHITE

OFFICERS

President

GEORGE H. COPPERS

Vice Presidents

THOMAS F. BURKE, *Bread*
HOWARD B. CUNNINGHAM, *Purchasing*
HARRY T. EGGERT, *Personnel Relations*
ALFRED W. KASTEN, *Asst. to President*
RUSSELL M. SHULTZ, *Operations*
WARREN S. WARNER, *Sales*

GEORGE A. MITCHELL	*Controller*
CHARLES S. WEBSTER	*Asst. Controller*
ALBERT T. BULLOCK	*Secretary*
HENRY C. TAYLOR	*Treasurer*
FREDERICK F. BRODESSER	*Asst. Secretary and Asst. Treasurer*

COUNSEL

EVERETT W. BARTO, *General Counsel*
WILLIAM E. MACKAY, *Asst. General Counsel*

TRANSFER AGENT
GUARANTY TRUST COMPANY
NEW YORK

REGISTRAR
FIRST NATIONAL BANK
NEW YORK